



March 18, 2019

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Re: Comment to Notice of Proposed Rulemaking – Standardized Approach for Calculating the Exposure Amount of Derivative Contracts:  
OCC, Capital Adequacy: Standardized Approach for Calculating the Exposure Amount of Derivative Contracts, Docket ID OCC-2018-0030;  
Federal Reserve Docket No. R-1629 and RIN 7100-AF22;  
FDIC Docket No. RIN 3064-AE80

The Tennessee Energy Acquisition Corporation (“Tennessee Energy”), is a public corporation and an instrumentality of the State of Tennessee and of its member municipalities. Tennessee Energy submits this comment letter in the above-referenced dockets. Tennessee Energy appreciates the opportunity to provide comments in response to the Notice of Proposed Rulemaking regarding proposed revisions to the standardized approach for calculating the exposure amount (“SA-CCR”) of derivatives contracts of large banks (the “Proposed Rule”). The Proposed Rule, issued jointly by the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (the “Board”), and the Federal Deposit Insurance Corporation (the “FDIC”, and together with the OCC and the Board, the “Prudential Regulators”)<sup>1</sup>, threatens to result in significant and unnecessary costs for Tennessee Energy and other end-user

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<sup>1</sup> Prudential Regulators, Notice of Proposed Rulemaking, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64660 (Dec. 11, 2018), available at <https://www.federalregister.gov/documents/2018/12/2018-24924/standardized-approach-for-calculating-the-exposure-amount-of-derivative-contracts>.

companies and governmental organizations. Specifically, Tennessee Energy is most concerned (i) that large banks acting in the role of prepaid gas supplier or commodity swap counterparty in natural gas prepayment transactions will be required, or will interpret the rule as requiring, capital-set asides beyond those that currently exist, if any, under current statutory and regulatory standards and (ii) that its hedging transactions with large banks will become more expensive as a result of the indirect imposition of margining requirements.

1. Introduction – Tennessee Energy's Participation in Derivatives Markets

Tennessee Energy's members included 26 municipalities, utility districts, and gas authorities in the State of Tennessee (the "Associated Municipalities") which own and operate public gas distribution systems. A listing of Tennessee Energy's Associated Municipalities is included as Attachment 1 to these comments. Tennessee Energy is a governmental entity. Its Board of Directors is comprised of representatives of its Associated Municipalities.

Tennessee Energy is a joint action gas supply agency that provides wholesale sales service to municipal gas systems. It is an end user that benefits from the statutory end user exception from mandatory clearing and the exemption from margining requirements.

Tennessee Energy is a continuous participant in the municipal gas marketplace, including the marketplace for long-term gas supplies, and is a participant in derivatives transactions both as part of gas prepayments and through hedging to insure against gas price increases. Long-term gas supplies are essential to enable Tennessee Energy to meet the needs of its customers for reliable, secure, firm natural gas deliveries at reasonable and competitive prices. One of the primary strategies to meet these needs which Tennessee Energy has pursued in recent years, is pursuing today, and intends to pursue in the years to come is the purchase of natural gas supplies through gas prepayment transactions under Internal Revenue Code Section 148(b)(4) and Treasury Regulations. Large banks and their commodities affiliates are among the primary participants in this marketplace as gas suppliers and/or as commodity swap counterparties. As such they provide an essential service to the municipal gas industry, one that we believe could not and would not be

replicated or replaced by other industry participants, at least not under market conditions that have prevailed over at least the past 12 years.

Gas prepayment transactions contain matched, customized commodity swaps as essential components. These are so-called “tear up” swaps. There is no mark-to-market exposure to either counterparty upon early termination of the swaps, only exposure for accrued but unpaid amounts owed by one party or the other.

Tennessee Energy completed its first gas prepayment transaction in 1996 and its sixth and most recent such transaction in the Fall of 2018. Through its active participation in this marketplace, it has saved its Associated Municipalities, other participating municipalities, and the gas consuming public millions of dollars in the price of gas for space heating, cooking, water heating and industrial applications.

## 2. The SA-CCR NOPR’s Effect and Potential Effect

The Prudential Regulators have proposed a new methodology for measuring derivatives counterparty credit risk known as the “Standardized Approach for Counterparty Credit Risk” or “SA-CCR”. As proposed, large banks would be required to adopt SA-CCR by July 2020.

As proposed, the SA-CCR methodology would significantly raise banks’ capital requirements for natural gas derivatives, with the largest impacts being on derivatives executed with end users, like Tennessee Energy. While banking organizations may absorb some of these increased capital costs, Tennessee Energy fears, and believes, that the potential magnitude of the increase will result in the following:

(1) The transfer of all or a significant portion of the increased cost to end users, including Tennessee Energy, which will have a direct effect on our costs, leading in turn to higher prices for natural gas service for our customers and the consumers they serve, and a negative impact on local economies, and potentially making gas prepayment transactions uneconomic for us;

(2) Increased pressure on banking organizations to collect margin from end users or submit transactions to exchanges for clearing, notwithstanding the hard-fought efforts by end users,

including Tennessee Energy, to be exempted from mandatory margin and clearing requirements; and

(3) A decrease in the overall liquidity in natural gas derivatives markets, as some banking organizations may choose to exit the market due to higher transaction costs, resulting in increased concentration risk and the lack of access to unique transactions such as gas prepayments and their customized commodity swaps.

### 3. Tennessee Energy End User Perspective

SA-CCR proposes increases in capitalization requirements that will increase the cost of doing business for banks participating in the natural gas markets as prepaid gas suppliers and as commodity swap counterparties. This would have the result of increasing the cost of natural gas prepayments for Tennessee Energy and therefore for consumers served by our municipal gas system customers. The economics of gas prepayments in the marketplace that have prevailed over the last several years make the successful completion of such projects difficult. Any increase in the cost to prepaid gas suppliers of providing the supply and/or on counterparties to participate in matched commodity swaps has a negative effect on our ability to close those transactions. We fear that if implemented, the SA-CCR could convince some banks to withdraw from the physical gas markets and commodity swap markets as it becomes more difficult to operate profitably in them. A reduction in the number of prepaid gas suppliers in the market will be detrimental to municipal gas systems.

Similarly, the imposition of margin requirements on our swap counterparties for hedging transactions that Tennessee Energy enters into to protect its Associated Municipalities and the consumers they serve against market price increases will unfairly and unreasonably result in increased costs for our gas consumers, in derogation of the express exemption from margin requirements established by Congress.

In sum, we are concerned that significant capital requirements for commodity derivatives with end users, including municipalities, may significantly affect the ability of municipal organizations such as Tennessee Energy to obtain reliable access to natural gas supplies through

gas prepayment transactions, as well as frustrate the policy goals of exempting end users, including municipalities, from mandatory clearing and margin requirements, ultimately resulting in increased costs to the consumer.

4. Conclusion

For the foregoing reasons, Tennessee Energy respectfully requests that the proposed SA-CCR NOPR should not be applied to banks' commodities transactions with end users, including governmental end users such as Tennessee Energy who utilize gas supply contracts and commodity swap contracts in the natural gas industry for long-term supply reliability, price competitiveness, and price protection for the consumers they serve.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "J. Mark McCutchen", is written over a horizontal line.

J. Mark McCutchen  
President and General Manager  
The Tennessee Energy  
Acquisition Corporation  
Clarksville, Tennessee

March 18, 2019

## **ATTACHMENT 1**

### **ASSOCIATED MUNICIPALITIES OF THE TENNESSEE ENERGY ACQUISITION CORPORATION**

BEDFORD COUNTY UTILITY DISTRICT  
BOLIVAR GAS DEPARTMENT, CITY OF BOLIVAR  
TOWN OF CENTERVILLE  
CLARKSVILLE GAS AND WATER, CITY OF CLARKSVILLE  
CITY OF CLIFTON  
GREATER DICKSON GAS AUTHORITY  
HARRIMAN UTILITY BOARD, CITY OF HARRIMAN  
HAWKINS COUNTY UTILITY DISTRICT  
CITY OF HENDERSON  
CITY OF HOHENWALD  
HORTON HIGHWAY UTILITY DISTRICT  
LEXINGTON GAS SYSTEM, CITY OF LEXINGTON  
TOWN OF LINDEN  
MARION NATURAL GAS SYSTEM, TOWN OF SOUTH PITTSBURG  
CITY OF MUNFORD  
OAK RIDGE UTILITY DISTRICT  
POPLAR GROVE UTILITY DISTRICT  
CITY OF RIDGETOP  
ROCKWOOD WATER, SEWER, AND GAS SYSTEM, CITY OF ROCKWOOD  
SAVANNAH UTILITIES, CITY OF SAVANNAH  
TOWN OF SELMER  
SOMERVILLE GAS DEPARTMENT, CITY OF SOMERVILLE  
SPRINGFIELD GAS SYSTEM, CITY OF SPRINGFIELD  
CITY OF COLLINWOOD  
WAYNESBORO GAS SYSTEM, CITY OF WAYNESBORO  
WEST TENNESSEE PUBLIC UTILITY DISTRICT